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SUBJECT: UKRAINE FINANCE MINISTER'S PECULIAR AVOWALS

Classified By: AMBASSADOR WILLIAM B. TAYLOR, REASONS 1.4(B) AND (D)

¶1. (C) Summary. Ukraine's Minister of Finance Viktor Pynzenyk told the Ambassador on December 4 that a change of leadership at the National Bank of Ukraine (NBU) is necessary to stabilize the country's faltering economy. Alluding to what he said was an inept inter-agency anti-crisis team, he decried the lack of policy coordination between the Ministry and the NBU, blaming NBU Governor Stelmakh for the impasse. At the same time, his own grasp of details appeared weak, as he couldn't comment in depth on Ukraine's financing gap, seemed to dismiss a previous conversation on loan "hryvniazation," and admitted to being left out of recent high-profile negotiations between the GOU and Morgan Stanley. Pynzenyk ventured into obscure musings on Russia and "non-standard times," giving the overall impression of an anxious and even overwhelmed actor in Ukraine's developing financial crisis. End summary.

Policy Dis-Coordination

¶2. (C) At a meeting he requested with the Ambassador on December 4, Finance Minister Pynzenyk was notably cogent while offering scathing criticism of the NBU and Governor Stelmakh. Describing his December 3 meeting with President Yushchenko and Stelmakh, Pynzenyk said the President had been compelled "to force" the NBU to fulfill its obligations. While Pynzenyk said he did not want to interfere with the NBU, action was needed to ensure that the NBU performed its vital role. In particular, he noted the NBU had failed to keep the exchange rate in a "correct range" that the markets could understand. Pynzenyk said the NBU should stop pumping excess liquidity into the banking system. It should also raise interest rates, make its interventions more transparent, and audit purchases of foreign exchange to ensure that buyers used foreign currencies for their stated purposes. Pynzenyk repeated three times that he planned to put these demands in a letter to Stelmakh.

¶3. (C) In response to the Ambassador's comments on the difficulty of changing the NBU's leadership during a time of crisis, Pynzenyk said he would have agreed with that argument a month ago, but he now felt the markets would welcome Stelmakh's dismissal. At the mention of former Rada Speaker Arseniy Yatsenyuk being out of a job, Pynzenyk smiled and quipped that he would not wish the NBU job on him.

¶4. (C) As the subject matter shifted, Pynzenyk wistfully detailed his views on the need for "non-standard policies" during today's "non-standard times." According to Pynzenyk, methods of regulating banks need to change, since banks are

not transferring the support they receive into the wider economy. He told the Ambassador that capital adequacy levels for banks should be "changed" -- presumably to a lower level -- so that "banks are not sitting on their money." Otherwise, Pynzenyk was not specific about how "countries of the world should respond to the problem." He passed to the Ambassador an open letter to world governments and central banks, in which he suggested that governments' attempts to revive the financial sector will not resolve the global crisis alone. He gave no further concrete examples in his letter or in his discussion with the Ambassador.

Financing Gap

15. (C) The Ambassador asked Pynzenyk to explain in more detail PM Tymoshenko's assertion, made in a November 4 letter to Treasury Secretary Paulson, that Ukraine's financing gap could reach \$27 billion. Pynzenyk claimed that the IMF derived this figure based on the Fund's calculations of Ukraine's external exposure. Later, Pynzenyk said the \$16.4 billion IMF program was never intended to cover the entire financing gap, and the GOU was now in discussions with the World Bank and EBRD for additional loans to help cover the shortfall. (Comment: On November 28, the resident IMF representative confirmed to us that the \$16.4 billion stand-by loan was calibrated to cover the projected gap over the next three years, based on needs of \$4.3 billion in 2008, \$10.07 billion in 2009 and roughly \$2.3 billion in 2010.)

Hryvniaization

16. (C) The December 4 meeting came just five days after Pynzenyk hastily called the Ambassador for an impromptu Saturday appointment to discuss the financial crisis. Among the topics mentioned during the weekend meeting, which took place in the Minister's office on November 29, Pynzenyk voiced particular enthusiasm for converting hard currency loans into hryvnia. Pynzenyk asserted that such a measure would spread risk and enhance loan performance. On December 4, the Ambassador returned to the subject, passing the U.S. Treasury Department's strong concerns about the scheme. Referring only to media rumors, Pynzenyk sharply denounced the notion of hryvniaization. He blamed journalists for fanning public worries, and he stated that Ukraine had no intention of introducing such a plan. As he backed away from speculation about the Ministry's role in converting dollar loans to hryvnia, Pynzenyk gave the impression he wanted to forget his previous endorsement to the Ambassador. Without being specific, Pynzenyk then said the NBU was discussing other voluntary actions "of a different measure." (Comment: Pynzenyk's reversal corresponded to President Yushchenko's public denial that his Secretariat was working on a hryvniaization scheme. It appears the idea of hryvniaization is dead for now, although NBU Council Chairman Petro Poroshenko suggested in recent days that borrowers be able to service at least the interest payments on dollar-based loans in hryvnia. End comment.)

Stabilization and Reconstruction Fund

17. (C) Pynzenyk revealed that little progress has been made in creating an institutional framework to deal with bank recapitalization and resolution. He said it was difficult to get any traction with the NBU, rehashing the fact that "philosophical differences" exist between the Ministry of Finance and the central bank. He commented on being "afraid when the state manages banks," particularly since the NBU's capacity to oversee nationalized banking assets and liabilities was "problematic." The Ambassador passed on to Pynzenyk that the Treasury Department was securing funding to work in tandem with the international donor community to provide technical assistance.

Anti-Crisis Legislation and the 2009 Budget

18. (C) Pynzenyk could not provide details on draft legislation now pending in the Rada that reportedly clarifies the GOU's anti-crisis regulations. He joked about the need for drugs to cope with the volume and array of bills apparently circulating among parliamentary committees. The Minister was doubtful about passage of a new budget before the beginning of the year. Not only was the Rada unable to deliver legislation due to the vacant speaker's position, there were, according to Pynzenyk, political curbs on many of the possible spending reductions. Pynzenyk suggested that only two copies of a draft budget have been circulated (at the Ministry and the IMF), but he dodged the Ambassador's questions on a projected revenue shortfall and whether the GOU's 2009 budget would meet the IMF's fiscal policy conditionalities. Pynzenyk appeared certain the GOU would stay afloat with a mechanism akin to the U.S. government's continuing resolution, though he did not explain how a decline in revenues might adequately fund flat-lined government spending for 2009.

Morgan Stanley Loan

19. (C) Pynzenyk could not comment on the status of discussions between Morgan Stanley and the Government of Ukraine that had been prompted by a rating downgrade and loan call on the state highway company Ukravtodor. The Minister stated he was not involved with Morgan Stanley, but he believed "things were moving in the proper direction." (Comment: Prime Minister Tymoshenko's office apparently has the lead on the Morgan Stanley negotiations. The Minister's remarks suggest information flow between Pynzenyk and Tymoshenko on this issue is limited. End comment.)

Russia's Economy

110. (C) Reiterating comments made in his November 28 discussion with the Ambassador, Pynzenyk insisted that the economic situation in Russia was severe, and that a weakened Russia would have strong negative repercussions for Ukraine. Pynzenyk said that statements by Russian officials about Ukraine needing to pay \$400/tcm for gas in 2009 were politically motivated. Russian leaders would have difficulty justifying cuts in state salaries and pensions, according to Pynzenyk, if Gazprom charged Ukraine less than \$400/tcm. But Ukraine "can't feed Russia." In an odd side comment, Pynzenyk said that killers were being trained in camps outside Moscow to murder people on Moscow's metro. The Russian government was performing such acts to divert people's attentions from real problems in society. Such Russian tactics presaged difficulties for Ukraine, especially if the Russian economy worsened.

Comment

111. (C) Minister Pynzenyk appeared stressed and unfocused, and he was less in command of his core policy issues than we have observed in the past. Coupled with blistering comments on the NBU's incapacity and poor coordination, Pynzenyk's mushy philosophical musings on the need for international collaboration, his digressions on Russian killers in the metro, and his lack of access on the Morgan Stanley case are all troubling portents of GOU problems in the face of a growing crisis. Pynzenyk's words and deeds are clearly those of a man in the hot seat.

TAYLOR